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April 24, 1984

To: Members of the Executive Board

From: The Secretary

Subject: St. Lucia - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with St. Lucia, which will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Stephens (ext. (5)8638).

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INTERNATIONAL MONETARY FUND

ST. LUCIA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the 1984 Article IV Consultation with St. Lucia

Approved by S. T. Beza and W. A. Beveridge

April 23, 1984

The 1984 Article IV consultation discussions with St. Lucia were held in Castries in the period February 20-March 7, 1984. The St. Lucia representatives included the Prime Minister, who is also Minister of Finance and Planning; the Director of Finance and Planning; the Director of Statistics; senior officials in the ministries; and representatives of the major public enterprises. The mission also met with commercial banks and private manufacturing enterprises. The staff mission consisted of Messrs. Stephens (Head), Da Costa, Ewenczyk, Ms. Spinola, and Ms. Archer (Secretary) (all WHD). The mission was assisted by Mr. Gantt, the Fund's Regional Advisor. St. Lucia has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement.

I. Recent Developments and Prospects

In the period 1977-79 real GDP grew at an average annual rate of about 10 percent a year under the impetus of a strong expansion in manufacturing, construction, and tourism; there was also a modest rise in agricultural output. Real GDP declined by 1.3 per cent in 1980 as a consequence of damage to agriculture and tourist infrastructure caused by Hurricane Allen. Output rose moderately in 1981 and 1982 (at an average rate of 2 1/2 percent a year) reflecting in part the post-hurricane recovery in agriculture and manufacturing (Table 1). Approximately the same rate of growth in output was recorded in 1983, but the pattern of growth was less balanced. A strong rise in banana production and further increases in tourism and manufacturing were partially offset by a pronounced fall in construction following completion of a large oil transshipment terminal.

An acceleration in the rate of growth in real GDP (to between 5 and 6 percent) appears to be in prospect for 1984. The major support to activity is expected to come from construction, boosted by a planned increase in the Central Government's capital expenditure on roads and other infrastructure, and from manufacturing, the projected growth of which is based on higher capacity utilization and on the establishment of new enterprises during the year. Tourism and tourist-related activities and agricultural output are likely to expand more moderately than in 1983.

Table 1. St. Lucia: Selected Economic and Financial Indicators, 1981-84

	1981	1982	1983	Proj. 1984
(Annual percentage changes, unless otherwise specified)				
National income and prices				
GDP at constant prices	2.7	2.5	2.0	5.9
GDP deflator	8.9	4.1	1.7	2.5
Consumer prices	15.0	4.6	1.5	2.5
External sector (on the basis of U.S. dollars)				
Exports, f.o.b.	-9.6	--	19.5	12.5
Imports, c.i.f.	4.1	-8.4	-9.6	8.1
Nominal effective exchange rate (depreciation -)	5.7	5.3	4.3	...
Real effective exchange rate (depreciation -)	9.2	2.0	-0.1	...
Central Government 1/				
Domestic revenues	3.9	20.3	4.3	10.1
Total expenditure and net lending	13.2	9.9	5.8	18.1
Money and credit 2/				
Domestic credit (net)	13.4	3.4	0.4 3/	8.7
Of which: Central Government	(0.9)	(3.2)	(4.9)	(--)
private sector	(16.5)	(8.1)	(7.2)	(8.0)
Money and quasi-money (M2)	14.7	5.2	8.8	7.9
Velocity (GDP relative to M2)	1.7	1.7	1.7	1.7
Interest rate (annual rate, 3-month deposits)	7.0	7.0	7.0	7.0
(In percent of GDP)				
Central government savings 1/	-0.8	-2.4	-0.1	2.9
Central government budget deficit (overall)1/	-6.2	-6.9	-3.5	-1.9
Domestic financing	0.5	2.1	1.3	-0.5
Foreign financing (including changes in foreign assets, ECCB and IMF)1/	3.8	2.9	0.8	2.4
Buildup of payments arrears (+)1/	1.9	1.9	1.4	--
Gross domestic investment	58.7	40.1	30.9	33.8
Gross domestic savings	13.6	6.8	12.8	16.6
Current account deficit (BOP)4/	-36.0	-28.3	-12.7	-14.4
External debt (including IMF)	19.3	20.7	21.1	17.4
Debt service as a percent of exports and service receipts 5/	1.6	2.9	2.7	4.3
Interest payments (in percent of exports and service receipts)5/	1.1	1.3	1.6	2.3
(In millions of SDRs, unless otherwise specified)				
Overall balance of payments	-3.6	1.1	-0.2	1.2
ECCA and other gross official reserves (months of imports)6/	1.1	1.1	1.2	1.3

Sources: Ministry of Finance and Planning; Statistical Department; Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Fiscal year beginning April 1.
2/ Changes in relation to liabilities to private sector at beginning of period.
3/ Net credit to the rest of the public sector and to nonbank financial institutions declined by roughly 10 percent as a result of a buildup of deposits.
4/ Includes private transfers.
5/ Excludes re-exports.
6/ Includes imputed share of ECCB's international reserves.

In the period 1979-81, aggregate domestic expenditure rose sharply in relation to GDP and there was a widening of the current account deficit. Increases in gross investment (mainly by the Government) for reconstruction following Hurricane Allen contributed importantly to an expansion in aggregate demand in 1982-83. This trend was reversed subsequently when gross domestic expenditure fell (in relation to GDP) as private investment dropped steeply following completion of the above-mentioned oil transshipment terminal. As a result, the current account deficit, which had reached 36 percent of GDP in 1981, fell to 28 percent and 13 percent of GDP in 1982 and 1983, respectively. The abatement of domestic demand pressures was accompanied by a reduction in the rate of inflation (as measured by the consumer price index) from 20 percent in 1980 to 4 1/2 percent in 1982 and 1 1/2 percent in 1983. This price performance benefited from a slowing down in the rate of increase of import prices.

The fragmentary information on wages does not permit a comprehensive analysis of wage trends. It appears, however, that upward pressure on wages has eased somewhat, although settlements have continued to provide for nominal wage increases in excess of price changes. Wage settlements in unionized industries provided for wage increases of 25 to 30 percent in 1981 for the first year and 15 to 25 percent for the second year of two-year agreements; those recorded in 1983 provided for average wage increases of 12 percent in the first year, and 8 percent in the second. For its part, the Central Government had reached an agreement with civil servants in April 1982, which provided for an average salary increase of approximately 37 percent (or 13 percent a year) for the contract period October 1980-March 1983. However, civil service pay for the 12 months beginning April 1, 1983 was frozen at existing levels.

The financial operations of the consolidated public sector 1/ showed a steady widening of the overall deficit from 4.3 percent of GDP in FY 1979/80 to 6.6 percent of GDP in FY 1982/83 (the fiscal year begins April 1), as surpluses of the National Insurance Scheme were partially offset by the overall deficits of the public enterprises and the Central Government. In FY 1983/84, the consolidated overall deficit on a commitment basis is estimated to have narrowed sharply (by the equivalent of 5 percent of GDP), on the strength of improved central government finances and a small overall surplus on public enterprise operations (Table 2).2/ This latter development resulted from a turnaround in the current account of the Banana Growers' Association (equivalent

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1/ This comprises the Central Government, two quasi-government bodies, the Castries City Council and the National Insurance Scheme, and seven nonfinancial public enterprises.

2/ Some public sector enterprise accounts are not up to date, and financial years are not uniform for all enterprises. Consequently, consolidated financial data for the rest of the public sector should be regarded only as indicative of trends. It should be noted also that expenditures are recorded when payment vouchers are issued.

Table 2. St. Lucia: Operations of the Consolidated Public Sector

	Fiscal Year Beginning April 1				
	1979	1980	1981	1982	Prel. 1983
(In millions of East Caribbean dollars)					
Total revenue and grants	93.12	103.42	116.85	123.72	152.35
Current revenue	82.66	94.47	100.47	116.78	130.12
Current grants	0.13	0.16	--	0.25	0.23
Capital grants	10.33	8.79	16.38	6.69	22.00
Total expenditure and net lending 1/	103.96	116.36	131.61	147.55	158.31
Current expenditure	76.05	81.36	95.18	119.58	117.88
Capital expenditure and net lending	27.91	35.00	36.43	27.97	40.43
Current account balance (excluding grants)	6.61	13.11	5.29	-2.80	12.24
Overall deficit (-)	-10.84	-12.94	-14.76	-23.83	-5.96
Change in payments arrears	6.25	-6.63	6.36	7.04	5.23
Overall deficit on cash basis (-)	-4.59	-19.57	-8.40	-16.79	-0.73
Financing	4.59	19.57	8.40	16.79	0.73
Foreign assets	-0.05	-0.48	0.75	-0.52	-0.38
Net borrowing from ECCB (including counterpart of purchases from IMF)	2.60	11.88	9.91	0.39	0.51
Other net foreign borrowing	9.05	0.93	1.64	10.41	2.59
Net domestic bank borrowing	-3.19	8.27	-10.11	2.23	-3.32
Other domestic borrowing	-3.82	-1.03	-6.21	4.28	1.33
(In percent of calendar year GDP)					
Total revenue and grants	32.5	34.1	34.5	34.3	40.4
Of which: revenue	28.9	31.1	29.6	32.3	34.4
Total expenditure and net lending	36.3	38.3	38.8	40.9	41.9
Of which: current expenditure	26.6	26.8	28.1	33.1	31.2
Current account balance	2.3	4.3	1.6	-0.8	3.2
Overall deficit	-3.8	-4.3	-4.4	-6.6	-1.6
Overall deficit on cash basis	-1.6	-6.4	-2.5	-4.7	-0.2

Sources: Ministry of Finance and Planning; and Fund staff estimates.

1/ Expenditure on a voucher issued basis.

to 2.5 percent of GDP), following a rise in both banana export volume and unit price in 1983, and marked improvements in the administration of the Association.

In the period FY 1979/80-FY 1981/82, the Central Government's finances were characterized by rising overall deficits, the accumulation of payments arrears in all but one year, and heavy borrowing from domestic and external sources. Total receipts (revenue and grants) rose relative to GDP, but the rise was insufficient to offset enlarged capital outlays and a modest increase in current spending (Table 3). As a result, the overall deficit on a commitment basis reached the equivalent of slightly more than 6 percent of GDP in FY 1981/82, compared with 3 percent in FY 1979/80. The overall deficit widened further to 7 percent of GDP in FY 1982/83. Revenues benefited from new tax measures, including a 2 percent tax on foreign exchange,1/ but total receipts rose only marginally in relation to GDP, as project-related grants declined from almost 5 percent of GDP in the previous fiscal year to 2 percent. Total expenditure, meanwhile, was boosted by payments under the above-mentioned wage award, which were only partially offset by reduced capital outlays. There was a further accumulation of payments arrears but the Government's financing requirements increased and were met by extraordinary issues of Treasury bills (which were purchased mainly by regional governments), net borrowing from the local commercial banks, and the issue of bonds to civil servants in lieu of cash payments for the major portion of their retroactive pay.

The Central Government's finances improved appreciably in FY 1983/84. Total receipts rose by some 18 percent from a year earlier, mainly on the basis of a more than threefold jump in project-related foreign grants. Total expenditure, by contrast, grew by less than 6 percent, with enlarged capital outlays more than accounting for the increase. Altogether, the overall deficit narrowed to the equivalent of 3 1/2 percent of GDP and the current account deficit was virtually eliminated. There was, however, a further accumulation of arrears and the Government again relied heavily on the local banking system to cover its cash deficit.

Notwithstanding the rise in net credit to the Central Government in 1983, the commercial banks were able to rebuild their liquidity which had come under pressure in 1982. This was facilitated by a 10 percent rise in private sector deposit liabilities, and a reduction in net claims on the rest of the public sector and on nonbank financial institutions. Among the latter were a few large depositors (such as insurance companies) that were induced to repatriate funds held overseas in response to a rise in domestic interest rates to levels that were competitive in relation to those abroad.

1/ The Executive Board was notified (in EBS/82/165) of the introduction of the tax on foreign exchange transaction, which the staff concluded did not constitute a multiple currency practice subject to Article VIII, Section 3.

Table 3. St. Lucia: Central Government Operations

	Fiscal Year Beginning April 1					
	1979	1980	1981	1982	Prel. 1983	Staff Proposal 1984
	(In millions of East Caribbean dollars)					
Total revenue and grants	82.81	93.86	104.64	113.08	132.95	164.86
Current revenue	72.35	84.91	88.26	106.14	110.72	121.93
Current grants	0.13	0.16	--	0.25	0.23	0.23
Capital grants	10.33	8.79	16.38	6.69	22.00	42.70
Total expenditure and net lending 1/	90.63	111.06	125.73	138.13	146.08	172.53
Current expenditure	73.21	80.49	90.92	114.82	111.17	109.83
Capital expenditure and net lending	17.42	30.57	34.81	23.31	34.91	62.70
Current surplus or deficit (-) (excluding grants)	-0.86	4.42	-2.66	-8.68	-0.45	12.10
Overall deficit (-)	-7.82	-17.20	-21.09	-25.05	-13.13	-7.67
Change in payment arrears (increase +)	6.25	-6.63	6.36	7.04	5.23	--
Overall surplus or deficit (-) on cash basis	-1.57	-23.83	-14.73	-18.01	-7.90	-7.67
Financing	1.57	23.83	14.73	18.01	7.90	7.67
Foreign assets	-0.05	-0.48	0.75	-0.52	-0.38	--
Net borrowing from ECCB (including counterpart of purchases from IMF)	2.60	11.88	9.91	0.39	0.51	-3.60
Other net foreign borrowing	1.07	0.13	2.43	10.61	2.79	13.37
Net domestic bank borrowing	-0.10	12.50	-2.60	4.19	5.20	--
Other domestic borrowing	0.36	3.33	3.75	4.50	2.11	-4.50
Residual	-2.31	-3.53	0.49	-1.16	-2.33	2.40
	(In percent of calendar year GDP)					
Total revenue and grants	28.9	30.9	30.9	31.3	35.2	40.2
Revenue	25.3	28.0	26.1	29.4	29.3	29.7
Grants	3.6	2.9	4.8	1.9	5.9	10.5
Total expenditure and net lending	31.7	36.6	37.1	38.3	38.7	42.0
Current expenditure	25.6	26.5	26.8	31.8	29.4	26.7
Capital expenditure and net lending	6.1	10.1	10.3	6.5	9.3	15.3
Current account balance	-0.3	1.5	-0.8	-2.4	-0.1	2.9
Overall deficit	-2.7	-5.7	-6.2	-6.9	-3.5	-1.9
Overall deficit on cash basis	-0.5	-7.8	-4.3	-5.0	-2.1	-1.9

Sources: Ministry of Finance and Planning; and Fund staff estimates.

1/ Expenditure on a voucher issued basis.

In the period 1979-82, the current account of the balance of payments was characterized by large deficits, averaging some 32 percent of GDP. For the most part those deficits reflected sizable imports of capital equipment associated with the construction of the Hess oil transshipment terminal. The current account deficit declined to about 13 percent of GDP in 1983 on the strength of a sharp rise in banana exports, an increased flow of private transfers, and a reduction in imports because of the completion of the oil terminal. The overall balance of payments deficits in 1980 and 1981, which averaged 3 percent of GDP, were financed largely by net borrowing from the Fund. The balance of payments recorded an overall surplus in 1982 and was close to equilibrium in 1983 (Table 4). The pickup in economic activity in 1984 is likely to lead to a widening in the current account deficit of the balance of payments which should be more than covered by foreign grants, disbursement of project-related loans, and other net capital inflows.

II. Economic Policies

Over the past two years, the Government has made some progress in strengthening the public finances and has improved the efficiency of the public sector. This latter achievement has resulted in a significant advance in St. Lucia's ability to absorb foreign development assistance. The authorities recognize, however, that the public finances continue to be weak. In their view, this weakness stems primarily from problems inherited from the previous administration, and, in particular, from the wage award in FY 1982/83. The authorities have accorded high priority to an early resolution of current fiscal difficulties and, in this regard, they indicated that the Central Government's savings should be equivalent to "10 percent of current revenues" by FY 1986/87. In these circumstances, the consultation discussions centered on the prospects for public finances in FY 1984/85 and on their implications for the Government's growth and employment objectives.

The staff was especially mindful of the comments made by Executive Directors in concluding the 1983 Article IV consultations with St. Lucia. It was then pointed out that required adjustment must necessarily fall on domestic measures, and in particular on wages and on fiscal policies, because of the constraints on the authorities which stemmed from St. Lucia's membership in a currency union. There was also agreement with the Government's focus on expenditures and, more particularly, containment of the wage bill, in its effort to arrest the deterioration in the public finances.

1. Growth and employment

The Government's strategy to relieve the unemployment situation and to strengthen the balance of payments involves an acceleration in economic activity to be achieved by intensive exploitation of St. Lucia's agricultural and tourist potential, and by industrial expansion based

Table 4. St. Lucia: Summary Balance of Payments

	1979	1980	1981	1982	1983	Proj. 1984
	(In millions of U.S. dollars)					
Goods, services, and private transfers	-31.5	-36.8	-45.2	-37.9	-17.8	-21.9
Exports, f.o.b.	31.9	46.0	41.6	41.6	49.7	55.9
Imports, c.i.f.	-101.2	-123.8	-128.9	-118.1	-106.8	-115.5
Of which: Hess Co.	(-19.0)	(-23.8)	(-29.1)	(-14.0)	(-6.2)	(-1.0)
Services (net)	30.0	29.9	27.2	27.6	27.3	25.7
Private transfers (net)	7.8	11.1	14.9	11.0	12.0	12.0
Capital account	31.9	38.2	44.3	26.3	10.5	23.2
Official grants	3.4	3.5	5.4	3.4	6.9	13.9
Public borrowing (net)	3.0	1.5	3.1	5.1	1.8	4.5
Of which: Central Government	(0.2)	(0.2)	(2.8)	(5.3)	(2.0)	(4.5)
Commercial banks	1.4	3.3	-1.5	-1.4	-5.6	--
Private direct investment	26.0	30.9	38.2	20.0	8.0	5.4
Of which: Hess Co.	(24.0)	(29.7)	(35.1)	(18.8)	(4.4)	(1.9)
Currency holdings 1/	-1.9	-1.0	-0.9	-0.8	-0.6	-0.6
Errors and omissions	-1.4	-5.0	-3.9	12.8	7.1	--
SDR allocation	--	0.5	0.5	--	--	--
Overall surplus or deficit (-)	-1.0	-3.1	-4.3	1.2	-0.2	1.3
Financing	1.0	3.1	4.3	-1.2	0.2	-1.3
Net ECCB borrowing	1.2	0.9	0.4	0.5	0.3	...
Change in foreign assets (increase -)	-0.2	-0.1	0.4	-0.1	-0.1	...
IMF borrowing	--	2.3	3.5	-1.6	--	-1.3
	(In percent of GDP)					
Current account deficit	-29.7	-32.7	-36.0	-28.3	-12.7	-14.4
Current account, excluding Hess Co.	-11.8	-11.6	-12.8	-17.9	-8.3	-13.8
Capital account 2/	28.8	29.9	32.6	29.2	12.6	15.3
Overall balance	-0.9	-2.8	-3.4	0.9	-0.1	0.9

Sources: Ministry of Finance and Planning; Statistical Department; and Fund staff estimates.

1/ Increase is East Caribbean dollars in circulation.
2/ Includes SDR allocation and errors and omissions.

on production for exports to extra-regional markets. The authorities believe that a strong revival in private sector activity, particularly in manufacturing and tourism, along with the Government's construction of related infrastructure, would permit a reduction in unemployment over the next few years from the currently estimated level of 22-25 percent. In this connection, the Government has been actively promoting foreign investment in St. Lucia, and as a direct consequence, manufacturing output should receive a boost in late 1984 and early 1985 from the establishment of certain manufacturing firms from the Far East; these firms have been attracted to St. Lucia, inter alia, on the basis of access to the U.S. market under the Caribbean Basin Initiative, and to the European Economic Community under the Lome Convention. With respect to tourism, the Government's plan calls for a near doubling of total hotel capacity within the next five to ten years, particularly if the external environment should remain favorable and local labor relations should continue to be harmonious. The authorities also indicated that a start had already been made to increase banana output through improved crop husbandry and the provision of supporting services, and that concerted efforts were being made to diversify agricultural output.

2. Fiscal policy

The representatives of St. Lucia noted that the Central Government's main fiscal objective was to generate annual current account surpluses equivalent to at least 10 percent of current revenue (3 percent of GDP in FY 1983/84). Because of the difficult financial situation, and the fact that a strong revival in economic activity was only just getting under way, that objective was not likely to be achieved before FY 1986/87 when the Government's finances should begin to benefit from the economic policies which are now being implemented. They shared the staff's view, however, that if decisive action were not taken now, especially with respect to restraining the growth in current expenditure, the expected "pay-off" might not be realized.

The trends and structure of expenditure were of particular concern to the St. Lucia authorities. In FY 1983/84, wage and salary payments constituted some 56 percent of total current expenditure. Interest payments, retirement benefits,1/ and contributions to regional and international organizations represented 15 percent. Altogether, statutory and contractual obligations accounted for 71 percent of current expenditure, a higher ratio than in FY 1982/83 when current expenditure included nonrecurring retroactive salary payments. Furthermore, the

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1/ Retirement benefits increased from EC$4.2 million in FY 1982/83 to EC$6.2 million in FY 1983/84. Higher pension entitlements associated with the salary increase apparently prompted a number of public servants to avail themselves of early retirement privileges. The fact that nearly all such retirees commuted a part of their pension entitlement was, to a very large extent, responsible for the increase in benefits. The authorities have indicated that, in the future, approvals for early retirement would be subject to much closer scrutiny.

relative share of subsidies and other transfers in total current outlays had grown to 11 percent in FY 1983/84, from 7 percent five years earlier. As a consequence, spending on goods and services, particularly repairs and maintenance, which the authorities regarded as essential if St. Lucia were to attract foreign invesment, has had to be curtailed. The relatively high proportion of current outlays that is accounted for by statutory and contractual obligations appeared to limit severely the scope for discretionary fiscal actions. In addition, the problems of arrears accumulated over the past three fiscal years needed to be addressed in order to safeguard the country's creditworthiness,1/ while the tight cash-flow situation was likely to persist. The Government's capital program is heavily weighted toward investment in agriculture, tourism, and manufacturing infrastructures, an emphasis the World Bank considers appropriate for St. Lucia. Capital outlays are expected to rise by some 80 percent in FY 1984/85, and are related mainly to projects under way for which foreign grants and concessional loans have already been secured.

At the time of the consultations, the authorities ruled out the adoption of new tax measures over the next two fiscal years on the grounds that taxation was already high; total revenue in FY 1983/84 was equivalent to 29 percent of GDP and tax revenue to 26 percent of GDP. With regard to expenditure, they stated that the Government was likely to be confronted with great difficulties in maintaining wages and salaries at existing levels; moreover, negotiations with civil servants for a salary increase averaging 7 percent a year in FY 1984/85 and FY 1985/86 were well advanced although they had not been finalized. The staff estimated that a salary increase of the size being contemplated would result in an overall deficit of nearly 3.5 percent of GDP and an unfinanced fiscal gap of 2 percent of GDP, even if other current expenditure were held constant, and the investment program were executed as planned. Such a gap would be inconsistent with the need to put the Central Government's finances on a sound basis so as to provide adequate resources for its investment effort, the orderly servicing of the country's external debt and, as a minimum, the avoidance of further payment arrears.

In the staff's view, an overall fiscal deficit of no more than 2 percent of GDP would represent an important step toward achievement of the Government's fiscal objectives. This target would imply an adjustment of 1 1/2 percent of GDP. The staff suggested that areas to be focused on included an increase of no more than 2 percent in the

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1/ The St. Lucia authorities have indicated that a list of outstanding arrears, by creditor, would be forwarded to the Fund staff as soon as it has been compiled. They are also expected to apprise the staff of any measures (including scheduled payments agreed with creditors) taken to reduce such arrears.

wage bill and reductions in transfers and subsidies,1/ which could account for approximately 1 percentage point, and that the remaining gap should be eliminated by additional measures, which the authorities would need to identify. The Central Government's operations as suggested by the mission would result in an overall deficit of 2 percent of GDP, and would be consistent with a current account surplus equivalent to close to 3 percent of GDP.

3. Wages and price policies

Upon assuming office in 1982, the present administration considered that the settlement reached by the previous administration with civil servants had raised wages and salaries above those obtainable for similar work in the private sector, and that the resulting wage bill exceeded the country's capacity to pay. It successfully persuaded civil servants to accept a moratorium on wage increases in FY 1983/84. Concurrently, the authorities issued wage guidelines calling for a ceiling of 10 percent a year in private sector wage settlements.

As noted above, the Government is in the process of negotiating with established civil servants a new wage agreement covering the two-year period FY 1984/85-FY 1985/86. In the view of the authorities, a further postponement of wage adjustments could trigger disruption in public services, thus frustrating the Government's effort to attract foreign investors. The staff argued that, apart from the purely financial aspects, the proposed salary increase of 7 percent in each year was well above the expected rate of inflation and, if granted, was likely to give the wrong signal to the private sector (where a number of important wage agreements could be renegotiated in 1984). This could seriously undermine the country's competitive position. Private sector wage settlements in 1983 provided for wage increases that were well in excess of domestic inflation, even though they generally fell within the Government's guidelines. In that context, the staff also suggested that the Government should consider lowering the upper limit of its wage guidelines.

The authorities said that private wage settlements in 1983 were by and large confined to relatively small establishments, where wages were relatively low and should not be regarded as pace-setting. They were confident that upcoming major wage agreements would still respect the existing guidelines. They further stated that modification of the guidelines would have to be carefully timed so as to maintain the support (including active participation in promotional tours abroad) of the labor movement's leadership.

1/ Steps have already been taken for a phased elimination of subsidies of rural water consumption (EC$1.8 million in FY 1983/84). The authorities have also indicated that measures would be taken to limit transfers to the Castries City Council, which have increased from EC$0.5 million in FY 1981/82 to EC$1.5 million in FY 1983/84.

In the area of price controls, no policy changes have taken place or are contemplated for the time being. Since 1980, a Prices Commission has advised the Price Control Division of the Ministry of Trade, Industry, Tourism, and Foreign Affairs on price controls. The authorities considered that controls protected the domestic consumer against excessive markups and, in their judgment, the system was not a deterrent to local producers. The controlled prices, mainly for imported goods, are in the form of either fixed maximum prices (for sugar, flour, bread, fish, meat, rice, propane gas, and fuel) or maximum markups (for most other imported foods, school supplies, and vehicles). Since the late 1960s, the Government has been the sole importer of sugar and rice, which are purchased in bulk and sold through private distribution networks. In 1980, the Prices Commission was designated to be the sole importer of cement, but that function was restored to the private sector in 1983.

4. Monetary policy

Given St. Lucia's institutional framework, there is limited scope for monetary policy. St. Lucia has no central bank of its own, and it shares with six other states a common currency, the East Caribbean dollar, issued by the Eastern Caribbean Central Bank. That institution superseded the East Caribbean Currency Authority on October 1, 1983 and has not yet used the statutory powers contained in its legislation.

Until 1982, interest rates on commercial bank deposits were not only lower than comparable rates abroad but were also below the domestic rate of inflation. In that year, commercial banks' liabilities to the private sector grew only moderately (by 6 percent) and their liquidity came under strong pressure. Interest rates have since become positive in real terms, reflecting both an upward movement in nominal rates and the decline in inflation. As noted above, that trend seemed to have been an important factor in the growth in financial savings intermediated by the banking system. In its effort to stimulate financial savings, the Government set a relatively high rate of return (10 percent, tax free) on bonds issued to civil servants in 1983 and also exempted interest earnings on bank deposits from income taxation.

5. External policies

St. Lucia's economy has been very sensitive to shifts in external conditions because it has no freely available foreign assets and only limited access to the resources held by the Eastern Caribbean Central Bank. The authorities had hoped to begin to build up a cushion of international reserves since FY 1982/83, but in view of the current state of the public finances this was no longer a short-term objective. St. Lucia's external debt service payments are relatively low, approximating 3 percent of foreign exchange earnings from exports and tourism in 1983, and are likely to remain low over the medium term, given St. Lucia's reliance on concessionary foreign financing.

The authorities pointed to the strong growth in export earnings in 1983, which contributed to a narrowing of the current account deficit of the balance of payments, and to the favorable prospects for exports in 1984. They noted that promotional efforts by the Government have begun to be reflected in a higher degree of extra-regional export-orientation, and a diversification of export markets.

Payments and transfers for current international transactions are subject to controls, but are not restricted. The surrender of exchange proceeds from exports and invisible transactions is mandatory, but not enforced. Although outward transfers of capital are in principle restricted, these restrictions are ineffective as there is freedom of capital movement within the ECCB region, and exchange controls and restrictions vis-a-vis the rest of the world differ in scope and degree of enforcement among ECCB's member states. In addition, banks can move funds freely within the region, and the ECCB does not impede the transfer of such funds by banks outside the region.

As a member of ECCB, the exchange rate of St. Lucia's currency--the East Caribbean dollar--can only be changed by unanimous agreement of member states. The East Caribbean dollar was pegged to the pound sterling at EC$4.80 per pound sterling until July 1976, when its peg was changed to the U.S. dollar at EC$2.70 per U.S. dollar. The real effective exchange rate of the East Caribbean dollar (with St. Lucia trade and tourism weights) depreciated by 4 percent from 1978 to 1979, but it has appreciated by 13 percent since then. The authorities have been concerned about the appreciation of the currency and the Government has requested the ECCB to conduct a study of the implications for St. Lucia and other member states.

III. Staff Appraisal

St. Lucia's economy experienced a relatively high rate of growth in the late 1970s, but suffered a setback in 1980 when a hurricane caused considerable damage to agriculture and tourist infrastructure. The economy has recovered since 1980, although the rate of growth has been moderate. In 1982 and 1983, domestic inflation decelerated sharply in response to an abatement of domestic demand pressures and the slowing down in the rate of price increase of imported goods. Indications are that a strong revival in private sector activity, a central element in the Government's growth and employment strategy, can be expected to contribute to an acceleration in the rate of growth in 1984.

How fiscal policies and wages evolve will determine to a large extent whether the Government's growth and employment objectives are achieved, particularly in view of the constraints on exchange rate policy deriving from St. Lucia's membership in the Eastern Caribbean Central Bank. The pursuit of cautious policies in the fiscal and wage areas is of great importance for the maintenance of a viable balance of payments and for the reduction of unemployment from the present high levels.

Wage policy, and its impact on the economy generally, and public finances in particular, continues to be a crucial issue in St. Lucia. The persistence of recent trends in private wage settlements could weaken significantly the competitiveness of the export and tourist sectors and thereby frustrate the achievement of the Government's objectives of reducing the level of unemployment through the establishment of labor-intensive industries. The staff commends the authorities for the firm stand taken on civil service wages and salaries in FY 1983/84 and recommends continuation of the same degree of restraint on the Government's wage bill in the fiscal year that started April 1, 1984. A restrained wage policy in the public sector would help to set the stage for further moderation in wage increases in the private sector.

Public finances and administration have improved notably over the past two fiscal years. However, the public finances still remain weak; substantial payments arrears have been accumulated and, consequently, further strengthening is needed. The Government's fiscal objectives are to generate resources equivalent to at least 10 percent of revenue for contribution to its investment efforts and the orderly servicing of its domestic and external obligations. Every effort should be made to achieve this objective in the fiscal year that started April 1, 1984, and thus reduce the overall deficit significantly. This would be consistent with no further buildup of arrears and the implementation of the Government's investment program, which is a key element in its development strategy. The Government also needs to make arrangements for the elimination of outstanding payment arrears.

The staff shares the concern of the authorities of St. Lucia about the structure of current expenditure which emerged in FY 1983/84. The relatively high ratio of statutory and contractual obligations to total current outlays severely limits the scope for judicious fiscal policy action; the staff would therefore urge the authorities to adopt corrective fiscal measures, including continued restraints on the Government's wage bill and reductions in transfers and subsidies.

The strong growth of export earnings registered in 1983 and estimated for 1984 is quite encouraging. Nevertheless, the authorities are right to be concerned about the real appreciation of the currency in recent years, and the staff endorses their request to the Eastern Caribbean Central Bank to study the implications of this appreciation for St. Lucia and other countries that are members of the Bank.

It is recommended that the next Article IV consultation with St. Lucia be held before December 1985.

St. Lucia - Fund Relations
(As of March 31, 1984)

I. Membership Status

(a) Date of membership: November 15, 1979
(b) Status: Article VIII

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota — SDR 7.5 million
(b) Total Fund holdings — 133.99 percent of quota
(c) Fund credit — 33.99 percent of quota

Of which:	Millions of SDRs	Percent of Quota
credit tranche	1.35	17.99
compensatory financing facility	1.20	16.00

(d) Reserve tranche position — None

III. Current Stand-by and Special Facilities

(a) Current stand-by or extended arrangement: None

(b) Previous stand-by arrangement: On November 21, 1980 the Executive Board approved a purchase of SDR 1.8 million by St. Lucia under the first and second credit tranches as emergency assistance following a hurricane disaster.

(c) Compensatory financing facility: Approval was given on March 27, 1981 for a purchase equivalent to SDR 2.7 million. On July 1, 1982 the Executive Board was informed that actual data showed an overcompensation of SDR 1.5 million. St. Lucia made the corresponding repurchase on October 12, 1982 (SDR 0.5 million) and on November 8, 1982 (SDR 1 million).

IV. SDR Department

(a) Net cumulative allocation: SDR 742,000
(b) Holdings: SDR 3,000 or 0.4 percent of net cumulative allocation
(c) Current Designation Plan: None

V. Administered Accounts

None.

VI. Overdue Obligations to the Fund

None

B. Nonfinancial Relations

VII. Exchange rate arrangement: since mid-1976 the East Caribbean dollar has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar.

VIII. Consultation with the Fund: the last Article IV consultation discussions were held in March 1983 and concluded by the Executive Board in June 1983 (SM/83/78 and SM/83/79). St. Lucia was included in the standard 12-month consultation cycle.

IX. Technical Assistance: a staff mission from the Fund's Bureau of Statistics visited Castries from March 30 to April 6, 1982 to discuss statistical developments. Mr. A. Osei, a member of the panel of fiscal experts, was assigned as Accounting Advisor to the Ministry of Finance from August 1980 until September 1982.

X. Mr. S. Stephens, the former Fund Regional Advisor to Antigua and Barbuda, Dominica, Grenada, St. Vincent and the Grenadines, and St. Lucia, was stationed in St. Lucia from January 13, 1982 to February 4, 1983, when he took up residence in Antigua. Mr. A Gantt, Fund Regional Advisor, has been accredited to St. Lucia since January 1984.

ST. LUCIA

Area and population	
Area	238 sq. miles (616 sq. kilometers)
Population (mid-1983)	125 thousand
Annual rate of population increase (1977-83)	1.5 percent
GDP (1983)	SDR 130.7 million
GDP per capita (1983)	SDR 1,045
Origin of nominal GDP (1983)	(percent)
Agriculture and fishing	16
Manufacturing	10
Construction	6
Government	22
Other	46
Ratios to GDP (1983)	
Exports of goods and nonfactor services	65.8
Imports of goods and nonfactor services	83.8
Central government revenues (fiscal year from April 1)	29.3
Central government expenditures (fiscal year from April 1)	38.7
External public and government-guaranteed debt (end of year)1/	18.1
Gross domestic savings	12.8
Gross investment	30.9
Money and quasi-money (end of year)2/	60.4

Annual changes in selected economic indicators	1980	1981	1982	1983
		(percent)		
Real GDP per capita	-2.8	1.2	1.0	0.5
Real GDP (at factor cost)	-1.3	2.7	2.5	2.0
Nominal GDP at market prices	6.0	11.6	6.5	4.6
Domestic expenditure (at current prices)	6.7	16.7	-2.1	-7.4
Investment	(16.3)	(9.7)	(-27.2)	(-19.5)
Consumption	(0.5)	(21.9)	(14.9)	(-2.2)
GDP deflator	9.2	8.9	4.1	1.7
Consumer prices (annual averages)	19.6	15.0	4.6	1.5
Central government revenues (fiscal year from April 1)	17.4	3.9	20.3	4.3
Central government expenditures (fiscal year from April 1)	22.5	13.2	9.9	5.8
Money and quasi-money 2/	11.9	14.7	5.2	8.8
Money	(6.1)	(7.2)	(10.7)	(-0.6)
Quasi-money	(14.8)	(18.1)	(3.0)	(12.9)
Net commercial bank assets 3/	19.5	13.4	3.4	0.4
Credit to Central Government (net)3/	(2.0)	(0.9)	(3.2)	(4.9)
Credit to private sector 3/	(30.3)	(16.5)	(8.1)	(7.2)
Merchandise exports (f.o.b, in U.S. dollars)	44.2	-9.6	--	19.5
Merchandise imports (c.i.f., in U.S. dollars)	22.3	4.1	-8.4	-9.6
Travel receipts (gross, in U.S. dollars)	21.3	-4.9	7.5	2.2

	1980	1981	1982	Prel. 1983
Central government finances (fiscal year from April 1)	(millions of East Caribbean dollars)			
Revenues and grants	93.9	104.6	113.1	133.0
Expenditures	111.1	125.7	138.1	146.1
Current account surplus or deficit (-)	4.4	-2.7	-8.7	-0.5
Overall surplus or deficit (-)4/	-17.2	-21.1	-25.0	-13.1
Overall surplus or deficit on cash basis	-23.8	-14.7	-18.0	-7.9
External financing (net)	12.0	12.3	11.0	3.3
Domestic financing (net) and residual	11.8	2.4	7.0	4.6
Balance of payments	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	46.0	41.6	41.6	49.7
Merchandise imports (c.i.f.)	-123.8	-128.9	-118.1	-106.8
Travel (net)	34.1	30.7	32.0	31.9
Other services and transfers (net)	6.9	11.4	6.6	7.4
Balance on current and transfer accounts	-36.8	-45.2	-37.9	-17.8
Official capital (net)5/	5.0	8.5	8.1	8.7
Private capital (net) and errors and omissions	28.2	31.9	30.6	8.9
SDR allocation	0.5	0.5	--	--
Change in official net reserves (increase -)	3.1	4.3	-1.2	0.2

1/ Excludes ECCB and IMF.
2/ Includes deposits of nonresidents.
3/ Changes in relation to liabilities to the private sector at beginning of period.
4/ On a commitment basis.
5/ Includes official grants.